

Comments Requested on Possible Amendments to Regulations Governing Chapter 42 Excise Taxes

Announcement 2002-47

The purpose of this announcement is to solicit comments addressing whether several regulations under Chapter 42 should be revised with respect to excise taxes imposed on foundation and organization managers to conform to recently-issued final regulations under section 4958 of the Internal Revenue Code (T.D. 8978, 67 Fed. Reg. 3076; 2002-7 I.R.B. 500). Section 4958 imposes taxes on any transaction that provides excess economic benefits to a person in a position to exercise substantial influence over the affairs of a public charity or a social welfare organization. Under section 4958, taxes are imposed both on the disqualified person who benefits from an excess benefit transaction and any organization manager who knowingly participates in an excess benefit transaction, unless the participation is not willful and is due to reasonable cause. The structure of these section 4958 taxes is similar to excise taxes imposed under Chapter 42 on certain transactions involving private foundations.

The final regulations under section 4958 published in January 2002 provide that an organization manager's participation in an excess benefit transaction will ordinarily not be considered knowing to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. For this purpose, appropriate professionals are legal counsel (including in-house counsel), certified public accountants or accounting firms with expertise regarding the relevant tax law matters, and independent valuation experts who meet specified requirements.

The requirements for appropriate valuation experts are modeled after the section 170 regulations that define *qualified appraisers* for charitable deduction purposes. Under the section 4958 regulations, the valuation experts must hold themselves out to the public as appraisers or compensation consultants; perform the relevant valuations on a regular basis; be qualified to make valuations of the type of property or services being valued; and include in the written opinion a certification that they meet the preceding requirements. See Treas. Reg. § 53.4958-1(d)(4)(iii). Organization managers may seek the opinion of such an expert to help determine whether the economic benefit provided to a disqualified person in a particular transaction represents fair market value (or reasonable compensation).

Like section 4958, sections 4941 (taxes on private foundation self-dealing), 4944 (taxes on investments which jeopardize a private foundation's exempt purposes), 4945 (taxes on taxable expenditures by private foundations), and 4955 (taxes on political expenditures of section 501(c)(3) organizations) also impose excise taxes on foundation managers or organization managers who knowingly participate in transactions prohibited under those sections, unless the participation is not willful and is due to reasonable cause. The regulations under each section contain a safe harbor for managers who disclose the factual situation to legal counsel and rely on a reasoned written legal opinion that the particular transaction is not a prohibited transaction. In such cases, the participation of the manager will not ordinarily be considered "knowing" or "willful", and will ordinarily be considered "due to reasonable cause". See Treas. Reg. § 53.4941(a)-1(b)(6); § 53.4944-1(b)(2)(v); § 53.4945-1(a)(2)(vi); § 53.4955-1(b)(7). Treasury Regulation § 53.4944-1(b)(2)(v) provides an additional safe harbor with respect to taxes on jeopardizing investments, where the foundation manager makes full disclosure to a qualified investment counsel and relies on the advice of such counsel. In that instance, the advice must be derived in a manner consistent with generally accepted practices of persons who are qualified investment counsel, and the opinion that a particular investment will provide for the

long and short term financial needs of the foundation must be expressed in writing. Treas. Reg. § 53.4944-1(b)(2)(v).

In connection with the section 4958 regulation project, some commentators suggested that the "advice of counsel" safe harbors contained in regulations under section 4941 (self-dealing) and section 4945 (taxable expenditures) be expanded to parallel the safe harbor for reliance on professional advice contained in the section 4958 regulations. Like section 4958, both sections 4941 and 4945 raise issues relating to the reasonableness of compensation.

Under section 4941, taxes are imposed on acts of self-dealing between a private foundation and its disqualified persons. Although most transactions between a private foundation and its disqualified persons are absolutely prohibited, section 4941 provides an exception for the payment of compensation for personal services that are reasonable and necessary to the foundation's exempt purposes, if the compensation is not excessive. See section 4941(d)(2)(E); Treas. Reg. § 53.4941-3(c)(1).

Section 4945 imposes taxes on taxable expenditures by private foundations, including any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B) (which lists exempt purposes of section 501(c)(3) organizations). Reasonable compensation may be an issue under section 4945 in connection with the standards for permitted administrative expenses. See Treas. Reg. § 53.4945-6(b).

By contrast, section 4944 (jeopardizing investments) and section 4955 (political expenditures) do not involve fair market value or reasonable compensation issues.

The section 4958 regulation project did not undertake any revisions to the advice of counsel safe harbors in other regulations under chapter 42. At this time, the IRS and the Treasury Department request comments on the issue of whether conforming revisions to the rules contained in the section 4958 regulations are appropriate or advisable in the case of any or all of the chapter 42 regulations mentioned above. Please send your comments addressing this issue, as well as comments addressing other areas of

Chapter 42 regulations that may need updating, to the following address by August 6, 2002, referencing Announcement 2002-47:

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